

Senate Bill No. 2060

CHAPTER 391

An act to amend Sections 25215, 25233, 25242, and 25535 of, and to add Sections 25248, 25249, 25250, 25251, 25252, 25253, 25254, 25255, and 25403 to, the Corporations Code, relating to investment securities.

[Approved by Governor August 24, 1998. Filed with
Secretary of State August 24, 1998.]

LEGISLATIVE COUNSEL'S DIGEST

SB 2060, Kopp. Investment securities.

Existing law, known as the Corporate Securities Law of 1968, regulates the issuance of corporate securities in the state and provides for the regulation by the Commissioner of Corporations of agents, broker-dealers, investment advisers, and investment adviser representatives.

This bill would, among other things, authorize the commissioner to issue certain orders directing the discontinuance of certain unsafe or injurious practices by those persons, and to levy certain administrative penalties in connection therewith. This bill would also require the commissioner to send a notice demanding remedial action to the principal officers of any broker-dealer or investment adviser that appears to the commissioner to be in an insolvent condition, conducting business in an unsafe or unauthorized manner, or engaging in certain other prohibited activities, and would authorize the commissioner to take possession, or to appoint a conservator to take possession, of the property, business, and assets of the broker-dealer or investment adviser, if the broker-dealer or investment adviser fails to comply with the notice, or to otherwise effect a remedy acceptable to the commissioner.

This bill would make certain related changes to notice and hearing requirements and would add certain other provisions related to the commissioner's administrative authority over broker-dealers and investment advisers.

Existing law makes it a crime to willfully violate any provision of the Corporate Securities Law of 1968.

By adding new provisions that would require broker-dealers and investment advisers to comply with certain orders of the commissioner, this bill would expand the scope of an existing crime, thereby imposing a state-mandated local program.

Existing law prescribes certain certification and notice filing requirements for investment advisers and investment adviser representatives. Existing law authorizes the commissioner by order, after appropriate notice and opportunity for hearing, to censure,

deny a certificate to, suspend for a specified period of time, or revoke the certificate of, an investment adviser for engaging in certain prohibited activities and for other specified reasons. Existing law prohibits any of these orders from being entered unless specified notice and hearing requirements are first satisfied.

Existing law also authorizes the commissioner, by order, after appropriate notice and opportunity for hearing, to censure, suspend for a specified period of time, or bar from any position of employment, management, or control of any investment adviser, broker-dealer, or commodity adviser, any officer, director, partner, or employee of, or any person performing similar functions for, an investment adviser, if that order is in the public interest and the person has violated certain specified provisions of law.

This bill would also prohibit any of these orders from being entered unless those specified notice and hearing requirements are first satisfied.

Existing law specifies instances in which the commissioner may summarily suspend or revoke the certificate of a broker-dealer or investment adviser.

This bill would additionally authorize that action in instances where the broker-dealer or investment adviser fails to maintain certain required capital to ensure its financial responsibility, or fails to maintain any book or records as required by the commissioner.

Existing law specifies certain qualification and filing requirements for the sale of securities, and specifies certain fraudulent and prohibited practices.

This bill would provide that every person who with knowledge directly or indirectly controls and induces any person to violate any provision of that law, or who knowingly provides substantial assistance to another person in violation of any provision of that law, is deemed to have committed a violation, as specified. The bill would also make it unlawful for any person directly or indirectly to do any act or thing which would be unlawful for that person to do under that law through or by any other person. In expanding the scope of persons subject to the criminal penalty provisions of the Corporate Securities Law of 1968, the bill would impose a state-mandated local program.

Existing law also provides that any person who violates any provision of the Corporate Securities Law of 1968, or who violates any rule or order under that law, shall be liable for a civil penalty in an amount not to exceed \$2,500 for each violation, as specified.

This bill would increase the amount of that civil penalty to an amount not to exceed \$25,000.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

The people of the State of California do enact as follows:

SECTION 1. Section 25215 of the Corporations Code is amended to read:

25215. No order may be entered under Section 25212, 25213, 25213.3, or 25252 except after notice to any person affected thereby (and, in the case of an agent, to his or her employer or prospective employer if known to the commissioner) of the intention of the commissioner to enter that order and of the reasons therefor and that upon receipt of a request the matter will be set down for hearing to commence within 15 business days after that receipt unless the person affected consents to a later date. If no hearing is requested within 30 days after the mailing of the notice and none is ordered by the commissioner, the order may be entered without hearing to remain in effect until it is modified or vacated by the commissioner. In the case of an original application for a certificate, that hearing shall be set down to commence within 15 business days after receipt of a written request by the applicant made 30 days or more after the filing of the application, even though no notice by the commissioner has been given, unless the applicant consents to a later date. If a hearing is requested or ordered, it shall be held in accordance with the provisions of the Administrative Procedure Act (Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code), and the commissioner shall have all of the powers granted thereunder.

SEC. 2. Section 25233 of the Corporations Code is amended to read:

25233. No order may be entered under Section 25232, 25232.1, or 25252 except after notice to the person affected thereby of the intention of the commissioner to enter that order and of the reasons therefor and that upon receipt of a request the matter shall be set down for hearing to commence within 15 business days after that receipt unless the person affected consents to a later date. If no hearing is requested within 30 days after the mailing of that notice and none is ordered by the commissioner, the order may be entered without hearing to remain in effect until it is modified or vacated by the commissioner. In the case of an original application for a certificate, such a hearing shall be set down to commence within 15 business days after receipt of a written request by the applicant made 30 days or more after the filing of the application, even though no such notice by the commissioner has been given, unless the applicant consents to a later date. If a hearing is requested or ordered, it shall be held in accordance with the provisions of the Administrative Procedure Act (Chapter 5 (commencing with Section 11500) of Part



1 of Division 3 of Title 2 of the Government Code), and the commissioner shall have all of the powers granted thereunder.

SEC. 3. Section 25242 of the Corporations Code is amended to read:

25242. (a) Surrender of a certificate as a broker-dealer or investment adviser becomes effective 30 days after receipt of an application to surrender that certificate or within a shorter period of time as the commissioner may determine, unless a revocation or suspension proceeding is pending when the application is filed or a proceeding to revoke or suspend or to impose conditions upon the withdrawal is instituted within 30 days after the application is filed. If a proceeding is pending or instituted, withdrawal becomes effective at a time and upon any conditions as the commissioner by order determines.

(b) If the commissioner finds that any broker-dealer or investment adviser is no longer in existence, or has ceased to do business as a broker-dealer or investment adviser, or is subject to an adjudication of mental incompetence or to the control of a committee or conservator or guardian, or cannot be located after reasonable search, the commissioner may by order summarily revoke the certificate of that broker-dealer or investment adviser.

(c) The commissioner may summarily suspend or revoke the certificate of a broker-dealer or investment adviser if he or she (1) fails to pay any fee required by Section 25608 or imposed pursuant to Section 25217, 25218 or 25236 within 10 days after notice by the commissioner that the fee is due and unpaid, (2) fails to file any report required under Section 25241 within 10 days after notice by the commissioner that the report is due, (3) fails to maintain any bond required by subdivision (e) of Section 25216 or by Section 25237, (4) fails to file an application pursuant to subdivision (a) of Section 25211 when required by subdivision (c) of that section, within the time specified therein or within 10 days after notice by the commissioner that the application is required, whichever last occurs, (5) fails to maintain any capital required by subdivision (c) of Section 25216 or by Section 25237, or (6) fails to maintain records as required by Section 25241.

SEC. 4. Section 25248 is added to the Corporations Code, to read:

25248. (a) If the commissioner finds, as a result of any examination or investigation or from any report made to the commissioner, that any person subject to this part, other than an investment adviser subject to Section 25230.1, is in an insolvent condition, or is conducting a securities, broker-dealer, or investment advisory business in such an unsafe, injurious, or unauthorized manner as to render further operations hazardous to the public or to customers, the commissioner may, by an order addressed to and served by registered or certified mail or by personal service on that person and on any other person having in his or her possession or

control any client funds, trust funds, or other property deposited with that person, direct discontinuance of the disbursement of client or trust funds by the parties or any of them, the receipt of client or trust funds, or other business operations. No person having in his or her possession any of these funds shall be liable for failure to comply with the order unless he or she has received written notice of the order. Subject to subdivision (b), the order shall remain in effect until set aside by the commissioner, in whole or in part, the person has been adjudged bankrupt, or pursuant to Section 25253, the commissioner has assumed possession of the broker-dealer or investment adviser.

(b) Within 15 days from the date of an order pursuant to subdivision (a), the person may request a hearing under the Administrative Procedure Act (Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code). Upon receipt of a request, the matter shall be set for hearing to commence within 30 days after that receipt unless the person subject to this division consents to a later date. If no hearing is requested within 15 days after the mailing or service of the notice and none is ordered by the commissioner, the failure to request a hearing shall constitute a waiver of the right to a hearing. Neither the request for a hearing nor the hearing itself shall stay the order issued by the commissioner under subdivision (a).

SEC. 5. Section 25249 is added to the Corporations Code, to read:

25249. If, after examination or investigation, the commissioner has reasonable grounds to believe that any broker-dealer or investment adviser has violated any law or rule binding upon it, the commissioner shall, by written order addressed to the broker-dealer or investment adviser, direct the discontinuance of the violation. The order shall be effective immediately, but shall not become final except in accordance with the provisions of Section 25251.

SEC. 6. Section 25250 is added to the Corporations Code, to read:

25250. If, after examination or investigation, the commissioner has reasonable grounds to believe that any broker-dealer or investment adviser, other than an investment adviser subject to Section 25230.1, is conducting business in an unsafe or injurious manner, the commissioner shall, by written order addressed to the broker-dealer or investment adviser, direct the discontinuance of the unsafe or injurious practices. The order shall be effective immediately, but shall not become final except in accordance with the provisions of Section 25251.

SEC. 7. Section 25251 is added to the Corporations Code, to read:

25251. (a) No order issued pursuant to Section 25249 or 25250 may become final except after notice to the affected broker-dealer or investment adviser of the commissioner's intention to make the order final and of the reasons for the finding. The commissioner shall also notify the broker-dealer or investment adviser that upon receiving a request the matter shall be set for hearing to commence

within 15 business days after receipt of the request. The broker-dealer or investment adviser may consent to have the hearing commence at a later date. If no hearing is requested within 30 days after the mailing or service of the required notice, and none is ordered by the commissioner, the order may become final without a hearing and the broker-dealer or investment adviser shall immediately discontinue the practices named in the order. If a hearing is requested or ordered, it shall be held in accordance with the provisions of the Administrative Procedure Act (Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code), and the commissioner shall have all of the powers granted under that act. If, upon the conclusion of the hearing, it appears to the commissioner that the broker-dealer or investment adviser is conducting business in an unsafe and injurious manner or is violating any law of this state, or any rule binding upon it, the commissioner shall make the order of discontinuance final and the broker-dealer or investment adviser shall immediately discontinue the practices named in the order.

(b) The broker-dealer or investment adviser may within 10 days after an order is made final commence an action to restrain enforcement of the order. If the enforcement of the order is not enjoined within 10 days by the court in which the action is brought, the broker-dealer or investment adviser shall comply with the order.

SEC. 8. Section 25252 is added to the Corporations Code, to read:

25252. The commissioner may, after appropriate notice and opportunity for hearing, by order levy administrative penalties as follows:

(a) Any person subject to this part, other than a broker-dealer or investment adviser, who willfully violates any provision of this division, or who willfully violates any rule or order adopted or issued pursuant to this division, is liable for administrative penalties of not more than one thousand dollars (\$1,000) for the first violation, and not more than two thousand five hundred dollars (\$2,500) for each subsequent violation.

(b) Any broker-dealer or investment adviser that willfully violates any provision of this division to which it is subject, or that willfully violates any rule or order adopted or issued pursuant to this division and to which it is subject, is liable for administrative penalties of not more than five thousand dollars (\$5,000) for the first violation, not more than ten thousand dollars (\$10,000) for the second violation, and not more than fifteen thousand dollars (\$15,000) for each subsequent violation.

(c) The administrative penalties shall be collected by the commissioner and paid into the State Corporations Fund.

(d) The administrative penalties available to the commissioner pursuant to this section are not exclusive, and may be sought and employed in any combination with civil, criminal, and other

administrative remedies deemed advisable by the commissioner to enforce the provisions of this division.

SEC. 9. Section 25253 is added to the Corporations Code, to read:

25253. (a) Whenever it appears to the commissioner that any of the conditions specified in subdivision (b) has occurred with respect to any broker-dealer or investment adviser subject to this division, the commissioner shall dispatch a written notice demanding remedial action and a summary of findings, as referred to in Section 25248, to the principal officer of that broker-dealer or investment adviser or to its manager of record.

(b) The conditions that require the commissioner to commence remedial action against a broker-dealer or investment adviser pursuant to subdivision (a) includes any of the following:

(1) The broker-dealer or investment adviser is in an insolvent condition.

(2) It is conducting its securities, broker-dealer, or investment advisory business in an unsafe or unauthorized manner.

(3) It has violated any rule or order adopted or issued pursuant to this division that is or has been necessary for the protection of any investor.

(4) It refuses to submit its books, papers, and affairs to the inspection of any examiner or investigator.

(5) It neglects or refuses to observe any order of the commissioner made pursuant to this division that is or has been necessary for the protection of any investor, within the time specified therein, unless the enforcement of the order is restrained in a proceeding brought by the broker-dealer or investment adviser.

(6) It has violated any provision of this division or any similar regulatory scheme of this state or a foreign jurisdiction relating to the protection of any investor.

(7) Any officer, director, stockholder, or partner of the broker-dealer or investment adviser, or attorney-in-fact of the broker-dealer or investment adviser has embezzled, misappropriated, or willfully diverted the assets or client or trust funds of the broker-dealer or investment adviser.

(8) It has permitted its capital to be lower than the minimum required by law, including any rule or order adopted or issued pursuant to this division.

(9) It has failed to comply with the bonding requirements of Chapter 2 (commencing with Section 25210) or Chapter 3 (commencing with Section 25230) of this part.

(c) The broker-dealer or investment adviser shall be afforded a reasonable opportunity to comply or otherwise effect those remedies specified in the written notice or any other remedies that the commissioner may deem acceptable. However, if the broker-dealer or investment adviser fails to comply within five days of receipt of the notice, or as soon as it appears to the commissioner that no

compliance is possible, or in the event prompt delivery of the written notice is impossible, the commissioner may take possession of the property and business of the broker-dealer or investment adviser and retain possession until the broker-dealer or investment adviser, subject to those conditions that the commissioner may prescribe, resumes its business or its affairs are finally liquidated.

(d) Whenever the commissioner has taken possession of any broker-dealer or investment adviser, the broker-dealer or investment adviser, within 10 days after the taking, may apply to the superior court to enjoin further proceedings in any California county or city and county in which the California office or offices of the broker-dealer or investment adviser is located. The court, after ordering the commissioner to show cause why further proceedings should not be enjoined and after a hearing and a determination of the facts upon the merits, may dismiss the application or enjoin the commissioner from further proceedings and direct the commissioner to surrender the property and business to the broker-dealer or investment adviser, or make any further order that may be just.

(e) If any facts occur that would entitle the commissioner under subdivision (b) to take possession of the property, business, and assets of a broker-dealer or investment adviser, the commissioner may appoint a conservator of the broker-dealer or investment adviser and require the conservator to post a bond. The conservator, under the direction of the commissioner, shall take possession of the property, business, and assets of the broker-dealer or investment adviser and take any action that the conservator deems necessary to conserve the assets of the broker-dealer or investment adviser pending further disposition of its business. The conservator shall retain possession until the property, business, and assets of the broker-dealer or investment adviser are returned to the broker-dealer or investment adviser or until further order of the commissioner.

(f) Subject to the other provisions of this section, a conservator, while in possession of the property, business, and assets of a broker-dealer or investment adviser, has the same powers and rights and is subject to the same duties and obligations as the commissioner while in possession of the property, business, and assets of a broker-dealer or investment adviser. During that time, the rights of a broker-dealer or investment adviser and of all persons with respect thereto, subject to the other provisions of this section, are the same as if the commissioner had taken possession of the property, business, and assets. A conservator, while in possession of the property, business, and assets of a broker-dealer or investment adviser shall have all the rights, powers, and privileges of the broker-dealer or investment adviser, its officers and directors or partners. All expenses of the conservatorship shall be paid out of the assets of the broker-dealer or investment adviser and shall be a lien thereon which shall be prior to any other lien.



(g) An investment adviser subject to Section 25230.1 is not subject to this section, unless that investment adviser or persons acting on behalf of that investment adviser committed any of the acts of fraud or deceit set forth in paragraph (7) of subdivision (b).

SEC. 10. Section 25254 is added to the Corporations Code, to read:

25254. (a) If the commissioner determines it is in the public interest, the commissioner may include in any administrative action brought under this part a claim for ancillary relief, including, but not limited to, a claim for restitution or disgorgement or damages on behalf of the persons injured by the act or practice constituting the subject matter of the action, and the administrative law judge shall have jurisdiction to award additional relief.

(b) In an administrative action brought under this part, the commissioner is entitled to recover costs, which in the discretion of the administrative law judge may include an amount representing reasonable attorney's fees and investigative expenses for the services rendered, for deposit into the State Corporations Fund for the use of the Department of Corporations.

SEC. 11. Section 25255 is added to the Corporations Code, to read:

25255. The civil, criminal, and administrative remedies available to the commissioner pursuant to this division are not exclusive, and may be sought and employed in any combination deemed advisable by the commissioner to enforce the provisions of this division.

SEC. 12. Section 25403 is added to the Corporations Code, to read:

25403. (a) Every person who with knowledge directly or indirectly controls and induces any person to violate any provision of this division or any rule or order thereunder shall be deemed to be in violation of that provision, rule, or order to the same extent as the controlled and induced person.

(b) Any person that knowingly provides substantial assistance to another person in violation of any provision of this division or any rule or order thereunder shall be deemed to be in violation of that provision, rule, or order to the same extent as the person to whom the assistance was provided.

(c) It shall be unlawful for any person directly or indirectly to do any act or thing which would be unlawful for that person to do under any provision of this division or any rule or order thereunder through or by any other person.

(d) Nothing in this section shall be construed to limit the power of the state to punish any person for any conduct which constitutes a crime under any other statute.

SEC. 13. Section 25535 of the Corporations Code is amended to read:

25535. (a) Any person who violates any provision of this law, or who violates any rule or order under this law, shall be liable for a civil penalty not to exceed twenty-five thousand dollars (\$25,000) for each violation, which shall be assessed and recovered in a civil action

brought in the name of the people of the State of California by the commissioner in any court of competent jurisdiction.

(b) As applied to the penalties for acts in violation of this division, the remedies provided by this section and by other sections of this division are not exclusive, and may be sought and employed in any combination to enforce the provisions of this division.

(c) No action shall be maintained to enforce any liability created under subdivision (a) unless brought before the expiration of four years after the act or transaction constituting the violation.

SEC. 14. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.

Notwithstanding Section 17580 of the Government Code, unless otherwise specified, the provisions of this act shall become operative on the same date that the act takes effect pursuant to the California Constitution.

